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HOTLINE ALLEGATIONS REGARDING ACCOUNTING
FOR THE DEFENSE INFORMATION SYSTEMS AGENCY
WORKING CAPITAL FUND

Report No. D-2001-123

May 21, 2001

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Abstract We performed this audit in response to a complaint made to the Defense Hotline. The complainant alleged that the Defense Finance and Accounting Service (DFAS) improperly accounted for funds in the Defense Information Systems Agency (DISA) Working Capital Fund. The complainant alleged that more than \$400 million in cross-disbursements (those made by organizations that did not perform accounting for DISA) could not be matched with liabilities, a substantial amount of expenses may not have been recorded, and that both DFAS and DISA delayed in resolving these problems to manipulate the DISA financial statements, making the operating results and reimbursable rates more favorable. The allegations were related to the Defense Enterprise Computing Centers business area, which is one of the two business areas within the DISA Working Capital Fund. The FY 2000 financial statements for the Defense Enterprise Computing Centers business area reported assets of \$205.5 million, liabilities of \$23.8 million, and expenditures of \$586.1 million. Cross-disbursements have created DoD-wide problems in matching disbursements and collections to proper supporting documentation. Disbursements that cannot be matched to supporting documentation and accepted by the accounting station are often referred to as undistributed or problem disbursements. A discussion of the allegations and conclusions is in Appendix B.		Monitoring Agency Acronym
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Acronyms

DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DECC	Defense Enterprise Computing Centers



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May 21, 2001

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE INFORMATION SYSTEMS
AGENCY

SUBJECT: Audit Report on Hotline Allegations Regarding Accounting for the
Defense Information Systems Agency Working Capital Fund
(Report No. D-2001-123)

We are providing this audit report for review and comment. We conducted the audit in response to a complaint made to the Defense Hotline alleging that the Defense Finance and Accounting Service improperly accounted for funds in the Defense Information Systems Agency Working Capital Fund. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments on Recommendation 1., we revised and redirected the recommendation to the Under Secretary of Defense (Comptroller). Therefore, we request that the Under Secretary of Defense (Comptroller) provide comments on Recommendation 1. by June 21, 2001.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. Marvin L. Peek (703) 604-9587 (DSN 664-9587) (mpeek@dodig.osd.mil) or Mr. Hoa H. Pham (703) 604-9588 (DSN 664-9588) (hpham@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

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Report No. D-2001-123

(Project No. D2000FC-0249)

May 21, 2001

Hotline Allegations Regarding Accounting for the Defense Information Systems Agency Working Capital Fund

Executive Summary

Introduction. We performed this audit in response to a complaint made to the Defense Hotline. The complainant alleged that the Defense Finance and Accounting Service (DFAS) improperly accounted for funds in the Defense Information Systems Agency (DISA) Working Capital Fund. The complainant alleged that more than \$400 million in cross-disbursements (those made by organizations that did not perform accounting for DISA) could not be matched with liabilities, a substantial amount of expenses may not have been recorded, and that both DFAS and DISA delayed in resolving these problems to manipulate the DISA financial statements, making the operating results and reimbursable rates more favorable. The allegations were related to the Defense Enterprise Computing Centers business area, which is one of the two business areas within the DISA Working Capital Fund. The FY 2000 financial statements for the Defense Enterprise Computing Centers business area reported assets of \$205.5 million, liabilities of \$23.8 million, and expenditures of \$586.1 million.

Cross-disbursements have created DoD-wide problems in matching disbursements and collections to proper supporting documentation. Disbursements that cannot be matched to supporting documentation and accepted by the accounting station are often referred to as undistributed or problem disbursements. A discussion of the allegations and conclusions is in Appendix B.

Objectives. The overall audit objective was to determine the validity of the allegations concerning the failures to record cross-disbursements, the existence of unrecorded expenses, and the efforts to resolve and disclose undistributed disbursements. We also reviewed the DFAS Cleveland and DFAS Pensacola management control programs as they related to our audit objective.

Results. We partially substantiated the allegation that a substantial amount of cross-disbursements could not be matched to liabilities. Also, we partially substantiated the allegation that efforts to resolve and disclose undistributed disbursements were slow. However, we did not substantiate the allegation that supportable expenditures were not recorded in the accounting records for DISA or that DISA and DFAS were trying to manipulate the financial statements.

DFAS Cleveland reported \$198.1 million of net undistributed disbursements in the September 2000 DISA Defense Enterprise Computing Centers business area statement

of financial position. Of the \$198.1 million, \$190.8 million (96 percent) was related to undistributed disbursements that occurred prior to FY 1997. However, DFAS and DISA have not been able to agree on how these undistributed disbursements should be resolved. As a result, the FY 2000 financial statements prepared by DFAS Cleveland for the DISA Defense Enterprise Computing Centers business area could not be relied on to be a complete and accurate presentation of financial reporting. The problem, if not corrected, will hinder DISA efforts to obtain a favorable audit opinion in future years. For details of the audit results, see the Finding section of the report.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) include a review of the undistributed disbursements in its DoD-wide effort to review cash balances for Defense Working Capital Funds, and at the conclusion of that review require a prior period adjustment for the DISA share of any remaining undistributed disbursements that cannot be allocated to other organizations based on the results of the DoD-wide review. We also recommend that DFAS Columbus locate the supporting documentation for the undistributed disbursements that should have been received by DFAS Pensacola.

Management Comments. DISA nonconcurred with a recommendation in the draft report to request the Under Secretary of Defense (Comptroller) for authority to write off net undistributed disbursements from inactive subheads to Non-Recoverable Accumulated Operating Results because DISA believed those disbursements had already been expensed. Therefore, entering the disbursements as an expense again would cause a double costing of the items in question. DFAS agreed to locate supporting documentation for undistributed disbursements and DFAS Columbus is in the process of researching the request to provide the appropriate documentation. See the Finding section for a discussion of management comments and the Management Comments section for the complete text of management comments.

Audit Response. Based on additional audit work and a joint initiative by the Under Secretary of Defense (Comptroller) and DFAS requesting an accounting firm to review account balances for DoD-wide working capital funds, we revised and redirected the recommendation to the Under Secretary of Defense (Comptroller). We request that the Under Secretary of Defense (Comptroller) respond to this report by June 21, 2001.

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Background

Hotline Allegations. This audit was conducted in response to a complaint made to the Defense Hotline. The complainant alleged that the Defense Finance and Accounting Service (DFAS) improperly accounted for funds in the Defense Information Systems Agency (DISA) Working Capital Fund. Included in the complaint were allegations that:

- DFAS Cleveland recorded a \$200 million cash overdraft as positive equity rather than a cash overdraft on the FY 1998 Defense Information Systems Agency financial statements. (The complaint stated that the problem was corrected at the end of FY 1999.)
- More than \$400 million of cross-disbursements could not be matched with liabilities, indicating that a substantial amount of expenses may not have been recorded.
- DFAS and DISA have been slow to resolve the problems so financial statements could be manipulated to make the operating results and reimbursable rates appear more favorable.
- DFAS Cleveland took unjustified personnel actions to prevent personnel from resolving problems identified.

See Appendix B for a complete discussion of the allegations. See the finding for audit conclusions and recommendations on how to resolve the disbursements that cannot be matched to supporting documentation.

DISA Working Capital Fund. The DISA Defense Working Capital Fund is financed on a reimbursable basis designed to provide an effective means of financing, budgeting, accounting for, and controlling resources as well as the costs of providing products and services used to support both peace and wartime operations. The DISA Working Capital Fund is divided into two large business areas—Communications Information Services Activity and Defense Enterprise Computing Centers (DECC). DISA provides a range of common user products and services found in the commercial sector that include telecommunication services, information technology products and services, customized procurement, automated data processing, and maintenance for the DoD community and other approved organizations. The FY 2000 financial statements for DISA reported assets of \$581 million, liabilities of \$517.6 million, and expenditures of \$2.4 billion. The DISA-DECC business area portion of total assets, liabilities, and expenditures was \$205.5 million, \$23.8 million, and \$586.1 million, respectively.

Role of the DFAS Cleveland and DFAS Pensacola. Prior to FY 1996, DFAS Columbus, DFAS Indianapolis, and DFAS Denver performed the detail-level accounting for DISA-DECC business area. At the end of FY 1996, DFAS Denver and DFAS Indianapolis ceased transmitting accounting data for 16 of the DISA-DECC business area activities. At the end of FY 1997, DFAS Columbus

ceased transmitting accounting data for approximately 36 DISA-DECC organizations. In FY 1995, the subhead 5F33¹ came into existence and is maintained by DFAS Pensacola.

DFAS Cleveland and DFAS Pensacola provided finance and accounting support for the DISA Working Capital Fund. However, various offices in DISA recorded commitments, obligations, and accruals for the fund using the Industrial Fund Accounting System. DFAS Pensacola maintained that system for DISA-DECC and recorded disbursements and other accounting information for DISA-DECC. DFAS Cleveland maintained departmental accounting records and prepared financial statements using data provided by DFAS Pensacola and other sources.

Objectives

The overall audit objective was to determine the validity of the allegations concerning the failure to record cross-disbursements, the existence of unrecorded expenses, and efforts to resolve and disclose undistributed disbursements. We also reviewed the DFAS Cleveland and DFAS Pensacola management control programs as they related to our audit objective. Appendix A discusses the audit scope and methodology and our review of the management control program.

¹The subhead is a four-digit suffix to the U.S. Treasury account number (basis symbol). The subhead is used to identify a subdivision of funds that restricts the amount or use for a certain purpose or identifies subelements with the account for management purposes.

Resolving Undistributed Disbursements

We partially substantiated the allegation that a substantial amount of cross-disbursements could not be matched to liabilities. Also, we partially substantiated the allegation that efforts to resolve and disclose undistributed disbursements were slow. However, we did not substantiate the allegation that supportable expenditures were not recorded in the accounting records for DISA or that DISA and DFAS were trying to manipulate the financial statements.

The DFAS Cleveland reported \$198.1 million of net undistributed disbursements in the September 2000 DISA-DECC statement of financial position.² Of the \$198.1 million, \$190.8 million (96 percent) was related to undistributed disbursements that occurred prior to FY 1997. However, as of December 2000, DFAS Arlington and DISA had not been able to resolve the \$190.8 million in undistributed disbursements because supporting documentation could not be located for those net undistributed disbursements. As a result, the FY 2000 financial statements prepared by the DFAS Cleveland for the DISA-DECC business area could not be relied on to be a complete and accurate presentation of financial reporting. If not corrected, the problem will hinder DISA efforts to obtain a favorable audit opinion in future years.

Background

Cross-disbursements and Undistributed Disbursements. Cross-disbursement transactions are disbursements and collections made by a disbursing office assigned to one DFAS site and accounted for by an accountable station assigned to another DFAS site, DoD Component, or Federal agency. Undistributed disbursements represent the amount of disbursements, as reported by the finance network, which have not been accepted by the operating level accounting entity.

Disbursing agents in the DoD and other Federal agencies disburse funds and report disbursements directly to the Department of the Treasury in the month of disbursal. Accounting offices responsible for recording the disbursements into the general ledger accounts do not receive the cash disbursement information until a later date. When the accounting office receives the cash disbursement information, the information may not contain the necessary data for the accounting offices to properly distribute to the fiscal station responsible for the disbursements. Accordingly, the lack of necessary data often creates a situation where the Department of the Treasury and the accounting office general ledger

²DFAS Cleveland prepared a monthly statement of financial position (M-1307 Report). Information supporting that statement was used to prepare the annual financial statements in support of the Chief Financial Officers Act.

accounts for disbursements are not equal, thus creating undistributed disbursements. To properly account for the discrepancies, the accounting office should perform monthly reconciliation of undistributed disbursements.

DoD-wide Problem Disbursements. Problem disbursements are disbursements that have not been, or cannot be, reconciled with official accounting records. Problem disbursements include both undistributed disbursements and unmatched disbursements. DoD and DFAS have recognized that problem disbursements occur throughout DoD and have extensive efforts underway to improve the disbursement process. Since 1992, DFAS has reported the undistributed and unmatched cross-disbursing and interfund transactions as a material control weakness in its Annual Statement of Assurance and developed a business plan to provide a centrally focused management effort to reduce the continued occurrence of undistributed disbursements. Also, DoD reported in its FY 1999 DoD annual financial statements that problem disbursements in DoD had as of September 1999 decreased from once totaling \$34.3 billion to a total of \$5.5 billion.

DISA-DECC Undistributed Disbursements

Recording Cross-Disbursements. During FY 1995 and FY 1996, information relating to the disbursements made by other disbursing stations and DFAS for DISA-DECC was sent directly to the Department of the Treasury. However, details of cash disbursement information was never sent to DFAS Cleveland and DFAS Pensacola for processing to DISA accounting records. As a result, a discrepancy between the Department of the Treasury and DISA-DECC accounting records existed. The problem became evident during FY 1997 and FY 1998 when the DISA-DECC statement of financial position showed a build up of undistributed disbursements. Based on information received, a significant amount of undistributed disbursements for FY 1997 and FY 1998 was based on disbursements made in FY 1995 and FY 1996 but never recorded in DISA accounting records. Review of accounting records maintained at DFAS Cleveland and DFAS Pensacola showed that the undistributed disbursements occurred because cross-disbursements of \$453.5 million were not posted in the DISA accounting records. Of the \$453.5 million in cross-disbursements in question, \$294 million pertained to active subhead 5F33; the remaining \$159.5 million pertained to DISA inactive subheads 5F30, 5F31, and 5F32.

Correcting Actions Taken by DFAS and DFAS Pensacola. According to the Defense Hotline complaint, DFAS personnel were slow in initially researching and obtaining vouchers to support expenditures made by other DFAS locations. However, beginning in FY 1999, DFAS Cleveland and DFAS Pensacola accounting personnel aggressively researched and obtained vouchers for about \$251 million in undistributed disbursements related to active subhead 5F33. Also, the Industrial Fund Accounting System was able to process an additional \$11.7 million in undistributed disbursements pertaining to active subhead 5F33. The remaining \$190.8 million was still unresolved because supporting vouchers for the summary net disbursements could not be located. Of the \$190.8 million,

\$31.3 million pertained to active subhead 5F33. The remaining \$159.5 million pertained to inactive subheads 5F30, 5F31, and 5F32, which DFAS Columbus, DFAS Indianapolis, and DFAS Denver used before the subheads were inactivated. As of September 30, 2000, the unresolved undistributed disbursements of \$190.8 million are shown in the table below.

Undistributed Disbursements Reported for Active and Inactive Subheads (dollars in millions)			
<u>Description</u>	<u>Active</u>	<u>Inactive</u>	<u>Total</u>
Undistributed Disbursements	\$294.0	\$159.5	\$453.5
Researched by DFAS Personnel	(251.0)	0	(251.0)
Processed by Accounting System	(11.7)	0	(11.7)
Unresolved Amount	\$ 31.3	\$159.5	\$190.8

A review of current accounting procedures at DFAS Pensacola showed that current undistributed disbursements related to subhead 5F33 were reconciled on a monthly basis and only \$7.2 million in net undistributed disbursements were reported on the DISA-DECC September 2000 statement of financial position. Also, in FY 2000, in an effort to resolve the undistributed disbursement issues, DFAS Arlington formed a team of personnel from DFAS Arlington, DISA headquarters, DFAS Indianapolis, DFAS Cleveland, and DFAS Pensacola to meet and review the process and the procedures related to controlling and tracking expenditure information. Jointly, the team developed a plan of action and milestones that would resolve the undistributed disbursements for DISA. When actions in the plan of action and milestones are completed, DISA will have accurate, supportable undistributed disbursement and collection information. As of September 30, 2000, the net undistributed disbursements that related to the FY 1995 and FY 1996 cross-disbursements for active subhead 5F33 were \$31.3 million. The team is scheduled to complete its work by September 2001.

Reasons for Delay in Resolving Undistributed Disbursements

The lack of supporting documentation for the \$190.8 million in unsupported disbursements was the primary cause of delay in resolving the undistributed disbursements. Also, a concern about increasing the reimbursable rate contributed to the continued reporting of a significant amount of undistributed disbursements in the DISA-DECC financial statements.

Undistributed Disbursements from Three Inactive Subheads. Net undistributed disbursements of \$159.5 million were related to the three inactive subheads—5F30, 5F31, and 5F32. Data from those subheads should have been closed out at the end of FY 1995 and transferred to the new subhead, 5F33, which is maintained by DFAS Pensacola. To properly close out and transfer the residual balances to subhead 5F33, DFAS Arlington and DISA would have to resolve the \$159.5 million in undistributed disbursements. However, clearing the net undistributed disbursements is remote because the vouchers could not be located to prove that the disbursements were correctly charged to DISA funds.

In December 1998, DFAS Cleveland recommended that the questionable undistributed net disbursements of \$159.5 million be closed to equity at the activity level after a prior period adjustment was recorded. We believe that expenses for these net undistributed disbursements were probably never recorded as expenses for DISA-DECC because an aging of the accounts payable in September 2000 showed that only \$38.4 million of accounts payable were more than 90 days old. DISA did not approve the recommendation because it did not want to take a loss to resolve the undistributed disbursements without supporting documentation to show that the disbursements were correctly made from DISA Working Capital Funds. As of December 2000, DISA and DFAS Arlington were not able to agree on how to resolve the \$159.5 million in net undistributed disbursements from the three inactive subheads.

Undistributed Disbursements from Active Subhead 5F33. The \$31.3 million in undistributed cross-disbursements was the residual of the \$294 million in undistributed disbursement related to DISA active subhead 5F33 from FY 1995 and FY 1996. DFAS Arlington did not want to take action to resolve the undistributed problem because DFAS Arlington was concerned that the effort in locating the vouchers for the remaining \$31.3 million was not complete. According to DFAS Cleveland accounting personnel, most of the questionable disbursements related to the \$31.3 million were disbursed at DFAS Columbus during FY 1995 and FY 1996. However, DFAS Columbus was not able to assist in locating the missing vouchers. As of December 2000, DFAS Arlington had not resolved the \$31.3 million in undistributed disbursements because of a lack of supporting documentation.

Review of Account Balances for DoD-Wide Working Capital Funds

Subsequent to issuance of the draft report, the Under Secretary of Defense (Comptroller) and DFAS began a joint initiative to review DoD-wide working capital fund account balances. On February 5, 2001, DFAS awarded a contract to an accounting firm to reconcile, validate, and document the significant accounting transactions that occurred within and or between working capital fund entities within DoD and other DoD appropriations. The DoD-wide effort is intended to resolve the longstanding problems with the accuracy of the Fund Balance With Treasury for Defense working capital funds. Personnel in the DoD Revolving Funds Directorate in the Office of the Under Secretary of

Defense (Comptroller) stated that undistributed problems related to DISA will be incorporated in the ongoing DoD-wide effort. At the completion of the review, any errors and account imbalances will be identified and the correcting entries will be apportioned and recorded. In addition, DISA and DFAS are in the process reviewing the transaction data, which is resident in the legacy system to identify and clear the aged undistributed problems.

Conclusion

DFAS Arlington, DFAS Cleveland, and DFAS Pensacola have taken actions to reduce the undistributed disbursements for DISA-DECC for prior years. However, as of December 2000, about \$190.8 million of the \$453.5 million in undistributed disbursements still remained. We support the current joint initiative of the Under Secretary of Defense (Comptroller) and DFAS to review Defense Working Capital Fund account balances, but do not believe the supporting documentation for the net undistributed disbursements of \$159.5 million for the three inactive subheads can be located. DISA and DFAS must resolve the \$159.5 million in undistributed disbursements with direction and assistance of the Under Secretary of Defense (Comptroller). We would also support efforts by the Under Secretary of Defense (Comptroller) to allocate undistributed disbursements for prior years among Defense Working Capital Fund entities in a equitable manner after exhaustive research has failed to obtain supporting documentation to match the disbursements to specific transactions. The remaining \$31.3 million from net undistributed disbursements in the active subhead (5F33) maintained by DFAS Pensacola pertaining to disbursements made by DFAS Columbus have not been located, and actions to obtain those vouchers have not been successful. The DISA financial statements will continue to be unreliable until the net undistributed disbursements is resolved.

Management Comments on the Finding

DISA Comments. DISA took issue with the statement that the FY 2000 DISA financial statements “could not be relied on to be a complete and accurate presentation of financial reporting.” DISA stated that the information supporting the FY 2000 activity is accurate and reliable. Only when the residual data from the legacy accounting applications are added do the accounts payable reflect an abnormal account balance. See the Management Comments section for the complete text of the DISA comments.

Audit Response. We did not review accounting activity for FY 2000 transactions and do not comment on the accuracy and reliability of FY 2000 transactions. However, the balance sheet reflects cumulative information, and the undistributed disbursements remaining on DISA accounting records from prior years affected the FY 2000 financial statements. Closing the undistributed disbursements to accounts payable for DISA-DECC created an abnormal balance in accounts payable, which indicates that liabilities for the undistributed

disbursements were probably not recorded. When undistributed disbursements exceed accounts payable, the financial statements are unreliable because it has not been determined whether the disbursements correctly belong to the organization. DISA appears to be aware of this concept because in the response to Recommendation 1. of the draft report, DISA stated that it recognizes that the undistributed disbursements must be resolved before DISA can achieve its goal of an unqualified audit opinion.

Recommendations, Management Comments, and Audit Response

Revised and Redirected Recommendation. Based on the recent DoD financial management initiative and comments on the draft report from DISA and DFAS, we revised and redirected Recommendation 1. to the Under Secretary of Defense (Comptroller). Recommendation 1., originally made to DISA, recommended that DISA obtain a waiver from the Under Secretary of Defense (Comptroller) to write off the net undistributed disbursements from the three inactive subheads through non-Recoverable Accumulated Operating Results.

DISA Comments. DISA nonconcurred with the recommendation because it believes that its expenses and liabilities were properly recorded. DISA also stated that the undistributed disbursement problems occurred because DISA was not able to access the legacy applications to take appropriate corrective actions that would match the disbursements to the correct account payable. Had this access been available, the value of unmatched disbursements would have been negligible. DISA is unwilling to enter the unmatched disbursements as an expense because it believes that the correct expenses were already recorded.

Audit Response. Subsequent discussions with DISA, DFAS, and the Under Secretary of Defense (Comptroller), along with additional audit work, determined that DISA will have to be charged with the net undistributed disbursements that cannot be allocated to other organizations or matched against existing accounts payable. We support the current joint initiative by the Under Secretary of Defense (Comptroller) and DFAS requesting a contractor to reconcile, validate, and document various accounting transactions for all DoD working capital funds. This initiative will also include a review of undistributed disbursements.

DFAS Comments. DFAS stated that DFAS Arlington formed a team of personnel from DFAS Indianapolis, DFAS Cleveland, DFAS Pensacola, and DISA. That team developed a plan of action and milestones that would resolve the undistributed disbursements for DISA by September 2001.

Audit Response. The plan of action and milestones mentioned by DFAS may have a limited chance to resolve the undistributed disbursements for the active subhead 5F33. However, the chance to resolve the undistributed disbursements for inactive subheads 5F30, 5F31, and 5F32 is unlikely because, as stated earlier, DFAS personnel had concluded that disbursement vouchers for the

questionable amounts were not available and DFAS had postponed further research for those vouchers. Therefore, we have revised Recommendation 1 in the draft report and redirected it to the Under Secretary of Defense (Comptroller). At the conclusion of the DoD-wide review of account balances of working capital funds, to include undistributed disbursements, the Under Secretary of Defense (Comptroller) will have to allocate any remaining undistributed (unmatched) disbursements from prior years among the various Defense working capital funds as prior period adjustments.

1. We recommend that the Under Secretary of Defense (Comptroller):

a. Include a review of the undistributed disbursements for the inactive subheads 5F30, 5F31, and 5F32 once used for the Defense Information Systems Agency Working Capital Fund, and the undistributed disbursements for the active subhead 5F33 currently used by the Defense Information Systems Agency Working Capital Fund in the ongoing DoD-wide effort to review cash balances for working capital funds within DoD.

b. Direct the Defense Information Systems Agency and the Defense Finance and Accounting Service to record a prior period adjustment for any remaining undistributed disbursements for the Defense Information Systems Agency Working Capital Fund that cannot be charged against accounts payable or allocated to other organizations based on the results of the DoD-wide review.

2. We recommend that the Director, Defense Finance and Accounting Service, direct Defense Finance and Accounting Service Columbus to assist Defense Finance and Accounting Service Cleveland and Defense Finance and Accounting Service Pensacola to locate the missing vouchers relating to the \$31.3 million from subhead 5F33.

DFAS Comments. DFAS concurred and stated that DFAS Columbus is in the process of researching the request to provide appropriate documentation. DFAS expects actions to be completed by September 30, 2001.

Appendix A. Audit Process

Scope

We reviewed the procedures and controls used by DFAS Cleveland and DFAS Pensacola to prepare financial information for DISA-DECC business area. Specifically, we reviewed the undistributed disbursements reported for DISA-DECC since 1997. We reviewed DFAS Pensacola reconciliation procedures and initiatives made by DFAS Cleveland, DFAS Pensacola, and DFAS Arlington to resolve the undistributed disbursements for DISA-DECC business area. Also, we reviewed the procedures used by DISA-DECC business area to record commitments, obligations, and accruals.

DoD-Wide Corporate-Level Government Performance and Results Act Coverage. In response to the Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following objectives and goals, and performance measures.

FY 2001 DoD Corporate-Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. **(01-DoD-02)**

FY 2001 Subordinate Performance Goal 2.5: Improve DoD financial and information management. **(01-DoD-2.5)**

FY 2001 Performance Measure 2.5.2: Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2.).**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objective and goal.

Financial Management Area. Objective: Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High Risk Area. The General Accounting Office has identified several high risk areas in the DoD. This report provides coverage of the Defense Financial Management high risk area.

Methodology

We reviewed applicable laws, policies, procedures, and regulations related to the undistributed disbursements, the recording of liabilities, and the journal vouchers related to the \$200 million in cash overdraft, along with the \$294 million in undistributed disbursements for DISA-active subhead 5F33. We judgmentally selected and reviewed \$53 million of the \$137 million in nonpayroll vouchers from disbursements that occurred in FY 1995 and FY 1996. We did not review the \$114 million in payroll vouchers because DFAS Pensacola already processed the payroll data in the Central Expenditure Reimbursement Processing System. We reviewed the DFAS Cleveland and DFAS Pensacola accounting records, and held discussions with DFAS Arlington, DFAS Cleveland, DFAS Pensacola, and DISA accounting personnel responsible for compiling, reviewing, and correcting financial information reported in the DISA consolidated financial statements.

Use of Computer-Processed Data. We relied on computer-processed data from the Industrial Fund Accounting System and the Central Data Base to conduct the audit at DFAS Cleveland and DFAS Pensacola. We relied on computer-processed data without performing tests of the system general and application controls because the process for reconciling and preparing journal vouchers is primarily a manual process. Not evaluating the controls did not affect the results of the audit.

Audit Type, Date, and Standards. We performed this financial-related audit from July 2000 through January 2001 in accordance with the auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Contacts During the Audit. We visited and contacted individuals and organizations in DoD. Further details are available on request.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of the DFAS Cleveland and DFAS Pensacola management controls over preparing and reporting financial information for DISA-DECC. Specifically, we reviewed the cash reconciliation process for the Industrial Fund Accounting System performed by DFAS Pensacola.

Adequacy of Management Controls. Although material weaknesses in reconciling undistributed disbursements occurred in the past, we did not identify

any material control weaknesses with the DFAS Cleveland and DFAS Pensacola procedures in reconciling current undistributed disbursements for DISA-DECC. The accounting procedures relating to the cash reconciliation performed at DFAS Pensacola would reduce the risk of building up the undistributed disbursements.

Adequacy of Management's Self-Evaluation. Managers at DFAS Cleveland and DFAS Pensacola identified the DISA accounting and DISA cash reconciliation process performed by the accounting divisions at both centers as assessable units. Also, DFAS Cleveland FY 1999 Annual Statement of Assurance reported the control of problem disbursements as one of its material control weaknesses.

Prior Coverage

The General Accounting Office and the Inspector General, DoD, have conducted multiple reviews related to the undistributed disbursements. General Accounting Office reports can be accessed on the Internet at <http://www.gao.gov>. Inspector General, DoD, reports can be accessed on the Internet at <http://www.dodig.mil/audit/reports>.

Appendix B. Hotline Allegations and Audit Results

The allegations and audit results as discussed in the audit report are summarized below.

Allegation 1. DFAS Cleveland recorded for FY 1998 a cash overdraft of \$200 million as positive equity rather than a cash overdraft.

Audit Results. The complainant stated that the problem was corrected in late FY 1999 by DFAS Cleveland. We confirmed that the correction was made.

Allegation 2. More than \$400 million in cross-disbursements could not be matched to liabilities, indicating that a substantial amount of expenses may not have been recorded.

Audit Results. The allegation was partially substantiated. However, we could not find any evidence that expenses were not recorded. Review of \$53 million of the \$137 million in cross-disbursement vouchers made during FY 1995 and FY 1996 showed that expenses were recorded and liabilities were established for the disbursements. Also, our review showed that \$294 million in undistributed disbursements related to DISA active subhead 5F33 occurred because detailed disbursement transactions made by other disbursing stations were not sent to DFAS Cleveland and DFAS Pensacola for processing. Beginning in FY 1999, DFAS Cleveland and DFAS Pensacola aggressively researched and resolved \$251 million of the \$294 million in undistributed disbursements that should have been accounted for by DFAS Pensacola. However, supporting documentation for the undistributed disbursements relating to the inactive subheads for \$159.5 million were not located. We believe that expenses for these disbursements were probably never accrued in the DISA accounting records because an aging of accounts payable in September 2000 showed that only about \$38.4 million of accounts payable were more than 90 days old. Without supporting documentation, no possibility exists to determine if these disbursements should be charged to DISA operations. The finding discusses the actions DFAS Arlington and DISA should take to resolve the remaining undistributed disbursements of \$159.5 million related to the inactive subheads and \$31.3 million related to the active subhead.

Allegation 3. DISA and DFAS have been slow to resolve the undistributed disbursements so that DISA and DFAS Pensacola could manipulate the DISA financial statements, thereby making DISA operating results and reimbursable rates appear more favorable.

Audit Results. The allegation was partially substantiated because the undistributed disbursements became evident during FY 1997, but DFAS Cleveland and DFAS Pensacola did not take aggressive corrective actions until FY 1999. However, at the time of our audit, both DFAS Cleveland and DFAS Pensacola had aggressively pursued the problem. We could not find any

evidence that DFAS Cleveland and DFAS Pensacola were trying to manipulate the financial statements. As stated in the finding, DFAS Cleveland and DFAS Arlington had aggressively researched and resolved the undistributed disbursement problems. However, DFAS Arlington and DFAS Cleveland were unable to locate vouchers to prove that the disbursements belonged to DISA, and DISA did not want to record the disbursements against the DISA fund without supporting documentation that showed the disbursements were legitimate. Also, DFAS Cleveland was unable to obtain assistance from DFAS Columbus in locating the missing vouchers for \$31.3 million related to the active subhead.

Allegations 4. DFAS Cleveland took unjustified personnel actions to prevent accounting personnel assigned to DISA from resolving the undistributed disbursements of the DISA.

Audit Results. We did not perform audit work on this allegation because the U.S. Office of Special Counsel found the allegation had no merit and made a preliminary determination to close the investigation.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service, Cleveland
Director, Defense Finance and Accounting Service, Pensacola
Director, Defense Information Systems Agency

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Defense Finance and Accounting Service Comments



DFAS-DAS

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291
WWW.DFAS.MIL




APR - 3 2001

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL DEPARTMENT OF
DEFENSE

SUBJECT: Audit Report on Hotline Allegations Regarding Accounting for the Defense
Information Systems Agency Working Capital Fund (Project No. D2000FC-0249)

Our response to the subject audit is attached. The point of contact is Mr. David Arvin,
(703) 607-2857 or DSN 327-2857.


Robert P. McNamara
Director for Accounting

Attachment:
As stated

cc:
DFAS-DDI
DFAS-AJIS/CL

Revised and
redirected

**DFAS Comments on Audit Report on Hotline Allegations Regarding Accounting for the
Defense Information Systems Agency Working Capital Fund
(Project No. D2000FC-0249)**

Responses to Recommendations.

Recommendation 1. We recommend that the Director, Defense Information Systems Agency, obtain a waiver from the Under Secretary of Defense (Comptroller) to write off the \$159.5 million in net undistributed disbursements from the three inactive subheads – 5F30, 5F31, 5F32- through Non-Recoverable Accumulated Operating Results.

Management Comments. Nonconcur. A team consisting of personnel from DFAS Arlington, DISA, DFAS Indianapolis, DFAS Cleveland, and DFAS Pensacola developed a plan of action and milestones that would resolve the undistributed disbursements for DISA. Implementation of the milestones and the actions in the plan is still underway.

Estimated Completion Date. September 30, 2001.

Recommendation 2. We recommend that the Director, Defense Finance and Accounting Service Arlington, direct Defense Finance and Accounting Service Columbus to assist Defense Finance and Accounting Service Cleveland and Defense Finance and Accounting Service Pensacola to locate the missing vouchers relating to the \$31.3 million from subhead 5F33.

Management Comments. Concur. DFAS Cleveland prepared a letter to DFAS Columbus specifying the exact period of time of the transactions to be researched, the appropriate line of accounting in question, and requesting that DFAS Columbus forward the applicable vouchers supporting those transactions to DFAS Cleveland. DFAS Columbus is in the process of researching the request to provide the appropriate documentation.

Estimated Completion Date. September 30, 2001.

Defense Information Systems Agency Comments



MEMO
REF ID: A66666
Inspector General (IG)

DEFENSE INFORMATION SYSTEMS AGENCY

701 S. COURTHOUSE ROAD
ARLINGTON, VIRGINIA 22204-2199

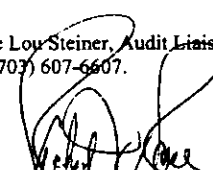
March 28, 2001

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: Finance and Accounting Directorate

SUBJECT: Response to DoD IG Draft Report, "Audit Report on Hotline Allegations
Regarding Accounting for the Defense Information Systems Agency Working
Capital Fund," January 30, 2001 (Project # D2000FC-0249)

1. The attached enclosure provides comments from the Defense Information Systems Agency on the above referenced DoD IG Draft Report. Specifically comments were requested from DISA on Recommendation 1.
2. If you have any questions, please call Ms Teddie Lou Steiner, Audit Liaison, at (703) 607-6316 or Jason Bakker, Assistant Audit Liaison, at (703) 607-6607.

For the Director:


RICHARD T. RACE
Inspector General

Enclosure a/s

Quality Information for a Strong Defense

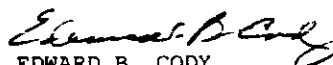
INTEROFFICE MEMORANDUM

TO: Inspector General (IG)
FROM: Comptroller (DC)
DATE: MAR 23 2001
SUBJECT: DOD IG Draft Report, Audit Report on Hotline
Allegations Regarding Accounting for the Defense
Information Systems Agency Working Capital Fund,
D2000FC-0249

Reference: DISA IM, IG, subject as above, 05 February 2001

1. In accordance with the reference memorandum, the subject report has been reviewed. We nonconcur with the recommendation and our detailed comments are enclosed.
2. My point of contact for this action is Mr. Stewart Petchenick, DC32, (703) 607-6400.

1 Enclosure a/s


EDWARD B. CODY
Comptroller

Comments to Hotline Recommendations and Findings

General Comments:

1. In the second paragraph of the "Results" section, the DODIG has identified the crux of the problem. The vast majority of the undistributed disbursements occurred before FY 1997. This is before DISA DECCs were consolidated in the Industrial Fund Accounting System (IFAS) for accounting operations. DISA DECCs position is that the liabilities/expenses were recorded, but unfortunately on what are now legacy accounting applications to which DISA no longer has access. The corrective actions necessary to match the undistributed disbursements to the appropriate liabilities cannot be performed by DISA because we can no longer access the various (six in all) legacy applications.

2. In the same paragraph, the DODIG states that "... the FY 2000 financial statements... were subject to misstatements and could not be relied on to be a complete and accurate presentation of financial reporting." DISA takes strong issue with that statement. Our position is that the data which details the FY 2000 activity is accurate and reliable and has been for each previous fiscal year in which IFAS has been the standard accounting application. It is only when the residual data from the legacy accounting application gets added (for eliminating entries), that accounts payable reflects an abnormal account balance.

Recommendation 1. We recommend that the Director, Defense Information Systems Agency, obtain a waiver from the Under Secretary of Defense (Comptroller) to write off the \$159.5 million in net undistributed disbursements from the three inactive subheads-5F30, 5F31 5F32-through Non-Recoverable Accumulated Operating Results.

DISA Response. Nonconcur. It is DISA's opinion that in the vast majority of instances, recovery/payment has been made and expenses/liabilities have been properly recorded. The standard DECC cost has consistently been between \$600 and \$700 million dollars for several consecutive fiscal years. This was true not only for the years the business area used the IFAS accounting application, but also while the DECCs were required to use

Revised and
redirected

Enclosure

multiple accounting applications. It is not plausible that \$160 million in cost has not been properly posted. DISA can state with certainty that the unmatched disbursements in question are the result of the DECCs not being able to access the legacy applications to take the appropriate corrective actions that would have matched the disbursements to the correct accounts payable. Had this access been available, the value of unmatched disbursements would have been negligible at most - probably nonexistent. It is DISA's conviction that entering the unmatched disbursements as expense would cause a "double costing" of the items in question.

We recognize the undistributed disbursements must be resolved before DISA can achieve its goal of an unqualified audit opinion. Central to this goal, OUSD(C), in collaboration with DFAS, is undertaking an initiative to resolve inaccurate balances in reports to include the impact of undistributed disbursements. The accounting firm of Grant Thornton has been retained to facilitate completion of the review. We intend to bring this issue forward during Grant Thornton's review of DISA. The current schedule has DISA being reviewed during a twelve month period commencing 17 May 2001.

Audit Team Members

The Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector, DoD, who contributed to the report are listed below.

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Andrea L. Hill